Case No. D60/88

<u>Interpretation</u> – meaning of 'including' – whether this extends meaning of preceding words or limits them – s 16(1) of the Inland Revenue Ordinance.

<u>Interpretation</u> – principles of interpretation of statutes – whether Board can speculate as to the legislature's intention if words of a statute are clear.

<u>Profits tax</u> – deductions – interest – intra-group borrowing where lender not subject to Hong Kong tax on interest received – whether interest costs deductible to borrower – ss 16(1) and 16(2) of the Inland Revenue Ordinance.

<u>Profits tax</u> – deductions – interest – whether s 16(2) exclusively regulated the allowance of deductions for interest – ss 16(1) and 16(2) of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Della P H Chan and E M I Packwood.

Date of hearing: 7 October 1988.
Date of decision: 22 December 1988.

The taxpayer company borrowed funds from its overseas parent and sought a deduction for the interest which it paid on this loan. The parent was not subject to either profits tax or interest tax on the interest which it received.

Section 16(1) of the IRO provides for a deduction for 'expenses to the extent to which they were incurred … by [the taxpayer] in the production of [chargeable] profits … <u>including</u> … (a) where the conditions set out in subsection (2) are satisfied … interest …'. The interest incurred by the taxpayer did not fall within any of the conditions of section 16(2). The IRD therefore denied a deduction to the taxpayer. It asserted that the word 'including' meant 'limited to' and that, if an interest payment did not fall within any of the provisions of section 16(2), it could not be deducted.

The taxpayer appealed. It argued that the specific provisions set out in section 16(2) could not operate so as to deny a deduction if the interest payments fell within the general introductory words of section 16(1). The taxpayer argued that the specific provisions of section 16(2) could not limit the general introductory words of section 16(1) and that the word 'including' should be read as extending and not limiting the meaning of those general words.

Held:

The taxpayer was entitled to deduct the interest payments made by it.

(a) The word 'including' in the general introductory words of section 16(1) is intended to extend the meaning of the preceding words and not to restrict them. Thus, the specific provisions of sections 16(1)(a) and 16(2) cannot limit the general introductory words of section 16(1) which have a life of their own.

(b) It therefore followed that sections 16(1)(a) and 16(2) did not constitute an exclusive code setting out the only circumstances in which a deduction for interest payments may be claimed.

(c) The interest payments incurred by the taxpayer clearly fell within the general introductory words of section 16(1) and therefore could not be excluded by sections 16(1)(a) and 16(2).

(d) When the meanings of the words of a statute are clear, it is not open to infer other meanings by looking at what might have been the intention of the legislature. This is nothing ambiguous about the word 'including' in section 16(1).

(e) Section 16(1)(a), which deals with interest deductions, is unnecessary because interest is deductible under the general introductory words of section 16(1).

Appeal allowed.

[Editor's note: The Commissioner of Inland Revenue has filed an appeal against this decision.]

Case referred to:

Lo & Lo v CIR (1984) 2 HKTC 34

G J Laird for the Commissioner of Inland Revenue.
Ian Anderson of Arthur Young for the taxpayer.

Decision:

This is an appeal by a limited company incorporated in Hong Kong against the refusal by the Commissioner to allow the company to deduct certain interest against its assessable profits. The facts are very simple so far as they are relevant and are as follows:

1. The Taxpayer is a Hong Kong incorporated limited company. It borrowed money from its overseas parent and interest was payable on that loan.

2. The Taxpayer claimed that the interest should be deductible against its assessable profits by virtue of section 16(1) of the Inland Revenue Ordinance.

3. The Commissioner refused the claim by the Taxpayer to deduct the interest because he maintained that the interest was not covered by section 16(1)(a) of the Inland Revenue Ordinance, and was therefore excluded from being deducted under section 16(1).

4. Both the Commissioner and the Taxpayer agreed that if the only interest which could be deducted under section 16(1) was that covered by section 16(1)(a), then the interest in question was not deductible.

5. Both the Commissioner and the Taxpayer agreed that if section 16(1)(a) did not exist, then the interest would be deductible under the general words of section 16(1).

This appeal depends entirely upon the interpretation of the word 'including' where it appears in section 16(1).

Commissioner's arguments

The representative for the Commissioner argued that 'including' in the context of section 16(1) does not have the meaning of 'inclusive of' but means 'limited to' or 'if not included by sub-paragraph 16(1)(a) then excluded'. The Commissioner's representative in his submission appeared to limit his argument to interest alone and did not refer to other possible deductions which might come within section 16(1) and/or any of the other sub-paragraphs in section 16(1).

The representative for the Commissioner took us through the history of profits tax in Hong Kong and the deductibility of interest. He also submitted that it was necessary to look at the intention of the legislature as stated by the Financial Secretary in his budget speech in 1984 and as set out in the Explanatory Memorandum to the subsequent bill which amended section 16 in 1984.

The Commissioner's representative took us back to when profits tax was first introduced as a levy to finance the war effort in 1941 and he traced the history of deductions of interest up to the present day. He said that it was not clear why it had been necessary to specify interest as being included in the general wording of section 16. In answer to questions from the Board, he said that it may have been that in those early days it was not clear whether all interest (for example interest on capital assets) would be deductible. However, today with modern business and accounting practices and policies, it is quite clear that all interest is deductible against profits where such interest is incurred in relation to the earning of such profits. He said that the legislature had chosen over the years to amend section 16(1)(a) or its equivalent whenever the legislature wished to vary the nature of interest which could be deducted from profits. He said that the final amendment followed the budget of the Financial Secretary in 1984 when the provisions of the Inland Revenue Ordinance were amended to make interest deductions more restrictive. He submitted that because it was the clear intention of the Financial Secretary that the only interest deductible under section 16(1) should be that covered by section 16(1)(a) and, as the interest in this appeal was not covered by section 16(1)(a), then it should not be deductible.

Taxpayer's arguments

The representative for the Taxpayer submitted that the word 'including' should be given its ordinary meaning and that it was not material that this interest was not within the provisions of section 16(1)(a). He said that if this interest would be deductible under the main wording of section 16(1), then section 16(1)(a) could not be interpreted as limiting the general meaning of section 16(1). He said that the sub-paragraphs appearing in section 16(1) after the word 'including' are by way of extension of section 16(1) and are not intended to restrict section 16(1) to only those items set out in the sub-paragraphs of section 16(1). He pointed out that if the legislature had wanted to restrict the interest which could be deducted under section 16(1), then such restrictions, if they were of general intent, should have been included in section 17 which is the exclusionary or restrictive section. He pointed out that the meaning of the Financial Secretary and the Legislature, whatever that may have been, is not material if the wording of the Inland Revenue Ordinance is clear. He said that whilst there are some examples of where the word 'including' has been given an exclusive meaning, this is only in extreme circumstances and only in contexts where it is quite clear that the inclusive part of the statutory provision is intended to be all-embracing.

Conclusion

To interpret section 16(1), it is necessary to look at the layout of part IV of the Inland Revenue Ordinance which relates to profits tax. Section 14 is the general charging section. It is drafted in the widest terms and says that all profits which arise in or derive from Hong Kong to a person who carries on a trade, profession or business in Hong Kong are taxable with the exclusion only of profits from the sale of capital assets.

Section 15 then deems certain receipts to be assessable profits within the overall charging section.

Section 14 does not attempt to set out rules and regulations or provisions as to how to calculate profits. The concept of section 14 is that commercial and normal accounting principles should prevail when ascertaining what is a profit.

Section 16 then specifies what is to be excluded when calculating the taxable profits. We will return again to the specific format of section 16 when we have dealt with the other relevant sections in part IV of the Inland Revenue Ordinance.

Section 16A permits certain payments to approved retirement schemes to be deducted from taxable profits. Sections 16B, 16C, 16D and 16E permit deductions for expenditure on scientific research, technical education, charitable donations and intellectual property rights.

Section 17 states what may not be deducted when calculating assessable profits.

The remainder of part IV comprises a series of other sections which deal with specific situations and/or allow or disallow specific items.

We now return to look in detail at the format of section 16 and we find that section 16(1) is in two parts. The first part is a general statement that all outgoings and expenses incurred in producing assessable profits are to be deducted. This first part of section 16(1) is drafted in the widest terms and the clear intention is that a taxpayer should pay tax only on his net profits after all outgoings and expenses have been deducted. This is a perfectly reasonable approach to be taken. Profits tax is intended to be a tax on net profits ascertained according to ordinary business and accounting principles.

It is quite clear from the format of part IV of the Inland Revenue Ordinance that section 16 was originally intended to provide exhaustively for what can be deducted when determining assessable profits. Section 16(1) is drafted in the widest terms and it permits the deduction of all outgoings and expenses which would normally be allowed under ordinary business and accountancy principles. This very wide section is then limited by section 17 which provides that certain items are not to be deducted.

In deciding this case, we find great assistance in the comparatively recent Privy Council decision of Lo & Lo v CIR (1984) 2 HKTC 34. That case depended upon the interpretation and meaning of section 16(1).

The Lo & Lo case, which is a binding authority on us, is most important and it is helpful to quote extensively from certain parts of the judgment given by Lord Brightman. At page 69, he made the following statement:

> ‘ Profits tax is imposed by Part IV of the Ordinance. Under section 14, which is the first section of Part IV, the tax is to be charged for each year of assessment on a person carrying on a trade, profession or business in the Colony “... in respect of his assessable profits arising in or derived from the Colony for that year from such trade, profession or business ... as ascertained in accordance with this Part”.

Section 2 contains a somewhat circular definition of assessable profits as "... profits in respect of which a person is chargeable to tax for the basis period for any year of assessment, calculated in accordance with the provisions of Part IV". The "basis period" for any year of assessment is defined as "the period on the income or the profits of which tax for that year ultimately falls to be computed"; in other words, it is the taxpayer's accounting period.

Section 16, which is the section upon which this appeal hinges, is in the following terms:

> "(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses, to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including ..."

The statutory inclusions are, shortly stated, as follows:

> "(a) sums payable ... by way of interest ...
>
> (b) rent paid ...
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> (c) tax ... paid elsewhere ...
>
> (d) bad debts incurred ...
>
> (e) expenditure incurred in the repair of any premises ...
>
> (f) expenditure incurred in the replacement of ...
>
> (g) ... a sum expended for the registration of a trade mark ...
>
> (ga) ... payments and expenditure on certain scientific research and technical education;
>
> (h) such other deductions as may be prescribed by any rule made under this Ordinance."

Sub-section (2) of section 16 has been repealed.

Section 17(l) provides that:

> "For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of ..."

and there follow a number of specific statutory exclusions, from (a) to (h), of which the following are examples:-

> "(a) domestic or private expenses, including the cost of travelling between residence and place of business;
>
> (b) any disbursements or expenses not being money expended for the purpose of producing such profits."

Sub-section (2) of section 17 forbids a deduction, in the case of a partnership, for salaries or other remuneration of partners or for interest on partners' capital or loans.

The narrow issue is whether the sum carried to reserve in respect of the aggregate "accrued" rights of long service employees to retirement benefits was "an expense incurred" during the year 1977 by the firm in the production of profits in respect of which they were chargeable to tax. The Board of Review having answered the question in the negative, the High Court and the Court of Appeal answered it in the affirmative.'

At page 71, Lord Brightman went on to say the following:

> 'The appellant conceded that under the United Kingdom system of taxation the sum in question would have been allowable as a deduction for the purpose of computing the amount of profits or gains chargeable to tax. It was submitted, however, that the United Kingdom system was fundamentally different from the Hong Kong system. In the United Kingdom, profits or gains fell to be accounted for on ordinary commercial principles subject to a prohibition against certain specified deductions. Under the Hong Kong system of taxation, the legislative scheme is to provide exhaustively for the items which may be deducted from receipts when ascertaining the taxable profit, regardless of good accountancy practice. In this respect the Hong Kong legislation was similar to that of Australia and New Zealand, where comparable sums had been held not to be deductible. The appellant referred in particular to CIR v Mutual Investment Company Limited [1967] 1 AC 587, where Sir Garfield Barwick, delivering the opinion of the Board, said (page 598):
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> > "It is clear enough that sections 16 and 17 provide exhaustively for the deduction side of the account which is to yield the assessable profits."

> This observation was made in the context of an earlier, but not significantly different, version of the Inland Revenue Ordinance.
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> It is perfectly correct to say that sections 16 and 17 provide exhaustively for the deductions which are permissible to be made, but not in the sense that permitted deductions are confined to the particular matters specified in paragraphs (a) to (h) of section 16(1). Sections 16 and 17 provide exhaustively for deductions in the sense that permitted deductions are confined to outgoings and expenses incurred in the production of profits in respect of which tax is chargeable; that such permitted deductions expressly include those specified in (a) to (h) of section 16(1), and expressly exclude those in section 17. In the opinion of their Lordships commercial considerations are not wholly to be disregarded in the course of this process. They are relevant for the purpose of deciding what can properly be treated as "outgoings and expenses ... incurred during the basis period ... in the production of profits in respect of which" the taxpayer is chargeable to tax.'

It is quite clear from the decision of their Lordships in the Lo & Lo case that the first part of section 16(1) has a meaning on its own and is not restricted to the items following the words 'including'. It is quite clear that, if the sub-paragraphs appearing in section 16(1) were exclusive, the Lo & Lo case would have been decided in favour of the Commissioner. None of the 'inclusive' sub-paragraphs (a) to (h) refer to the deduction of long service benefits. Accordingly in the present case we have the clearest interpretation from the highest court that the first part of section 16(1) stands in its own right and that the following sub-paragraphs are no more than items included therein but are not exclusive.

The only way that the Commissioner can be successful in the present appeal would be for us to give section 16(1) the interpretation that the first part of section 16(1) is general and all embracing in its terms save and except that, if any of the sub-paragraphs following the word 'including' cover a particular type of outgoing or expense, then that type of outgoing or expense is to be limited to whatever may be included in that sub-paragraph. With due respect, we cannot read any such meaning into the words of section 16(1). The 'inclusive' sub-paragraphs of section 16(1) are nothing more that. They are merely matters which are included. They do not and cannot limit the meaning of the main part of section 16(1). Furthermore, we are not prepared to take section 16(1)(a) on its own apart from the other sub-paragraphs and say that interest must stand apart and only be deductible if it is covered by that sub-paragraph.

We obtain further support for the Taxpayer from the Lo & Lo case because section 16A of the Inland Revenue Ordinance specifically provided for the deduction of payments to approved retirement schemes. Prior to the Lo & Lo case, the Commissioner had maintained that only payments made to approved schemes could be deducted from assessable profits. In the Lo & Lo case, in the Privy Council, it was not submitted that section 16A was all-encompassing with regard to deductions for long service benefits. Notwithstanding the clear wording of section 16A, the Privy Council allowed further deductions for long service benefits. If the sub-paragraphs of section 16(1) are restrictive in meaning, then surely section 16A should likewise limit section 16(1). It is worth noting that, following the Lo & Lo case, the Financial Secretary proposed and the Legislature passed a number of amendments to section 17 to limit the effect of the Lo & Lo decision. This reinforces the proposition that, when the Legislature wishes to restrict deductions, section 17 is the appropriate section to use.

It is not for us to speculate as to what the Legislature and/or the Financial Secretary may or may not have intended when, on various occasions, they amended the provisions of section 16(1)(a) relating to interest. Where the meaning of the words of a statute are quite clear, it is not open to infer other meanings by looking at what may or may not have been the intention of the legislature or the person introducing the legislation. It is necessary to look at the clear words used in the statute and nothing else. In this appeal, we can find nothing ambiguous about the word 'including' where it is used in section 16(1). Indeed, the word 'including' appears in other sections including the definition section, section 2. We have often heard the Commissioner argue that the definitions in section 2 which have the word 'including' are inclusive and not restrictive or exclusive. To hold that the word 'including' in section 16(1) should have a different meaning to the same word in other parts of the same Ordinance would require the plainest possible language. If, as the Commissioner's representative has said, the draftsman or the Financial Secretary wished to limit what interest can be deducted, then he should have done so by means of section 17 or by introducing another section or sub-section which makes it quite clear that only the interest defined is allowable as a deduction.

It appears to this Board of Review that the draftsman, when he introduced the words 'where the conditions set out in sub-section (2) are satisfied' and sub-sections 16(2), (3), (4) and (5), may well have made a mistake. Though the Commissioner's representative suggested a reason for sub-paragraph (a) being included in section 16(1), it seems to us that, at least by 1984, there was no need for sub-paragraph (a). Interest is and was deductible under the general words of section 16(1) as being an expense incurred in the production of profits. Leonard VP in the Lo & Lo case took the same view regarding section 16A when at page 64 he said:

> 'Does the presense of section 16A alter the position? It was not suggested before us that it did and I think this is the correct approach. On my interpretation it is unnecessary and in thinking that it was necessary the legislature made a mistake of law. This mistake cannot change the law.'

Perhaps the draftsman of the 1984 amendments and the Legislature made the same mistake in relation to the necessity for section 16(1)(a).

If we were to decide in favour of the Commissioner, we would have to hold that the only deductible interest is that which satisfies the conditions of sub-section 16(2). First of all, we note that the conditions of sub-section 16(2) are not disjunctive because the word 'or' has not been included, and the amendment to section 16(1)(a) requires 'the conditions' to be satisfied and not any one or more thereof. Does this mean that only public utilities which are also financial institutions can deduct interest? We think not.

Likewise, what is the meaning of section 17(2) which disallows interest on certain partnership capital and loans which would not in any event be allowable if the only permissible interest must comply with the conditions of section 16(2).

Another problem would be to reconcile the deduction of interest on trade credits, outstanding debts and other such interest if the only deductible interest must fall within the now very restrictive meaning of section 16(1)(a).

These are all problems inherent in looking beyond the clear words of section 16(1) and trying to import the meaning which the Commissioner submits should be given to the 1984 amendments.

For the foregoing reasons, we allow this appeal and direct that the assessment appealed against be remitted to the Commissioner to allow by way of deduction the interest claimed.